

## Message Text

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O R 100835Z FEB 77  
FM AMEMBASSY ROME  
TO SECSTATE WASHDC IMMEDIATE 2687  
TREASURY DEPT WASHDC IMMEDIATE  
INFO USMISSION EC BRUSSELS  
AMCONSUL MILAN  
AMCONSUL NAPLES  
USMISSION OECD PARIS  
AMCONSUL FLORENCE  
AMCONSUL GENOA  
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LIMDIS

PASS FRB

E. O. 11652: GDS  
TAGS: EFIN, ECON, IT  
SUBJ: ITALIAN STABILIZATION PROGRAM: AN ASSESSMENT

REF: ROME 1940

1. SUMMARY. WITH DECREE LAW ON LABOR COSTS APPROVED  
BY CABINET FEBRUARY 4 (REFTEL), CURRENT PHASE OF  
ITALIAN ECONOMIC STABILIZATION PROGRAM IS NOW ESSENTIALLY  
COMPLETE. WHILE TOTAL FISCAL AND LABOR COST PACKAGE  
IS SOMETHING OF A HODGEPODGE, IT SHOULD BE LARGE  
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ENOUGH TO SLOW DOWN ECONOMIC GROWTH IN 1977 SUFFICIENTLY  
TO RESTORE ROUGH BALANCE IN THE CURRENT ACCOUNT OF  
THE BALANCE OF PAYMENTS AND TO DECELERATE PRICE  
INCREASES SIGNIFICANTLY. HOWEVER, PROGRAM DOES  
NOT SERIOUSLY PROVIDE FOR PERMANENT STRUCTURAL  
REFORMS, PARTICULARLY WITH REGARD TO PUBLIC EXPENDITURES  
AND LABOR COST PROBLEMS. UNLESS SIGNIFICANT

PROGRESS IS MADE ON THOSE TWO ISSUES DURING 1977,  
 CURRENT STABILIZATION EFFORT WILL MERELY HAVE TEMPORARILY  
 MITIGATED BALANCE OF PAYMENTS AND INFLATION PROBLEMS  
 AND STOP-GO ECONOMIC GROWTH PATTERN WILL CONTINUE.  
 ANDREOTTI GOVERNMENT HAS MADE SERIOUS EFFORT TO DEAL  
 WITH AT LEAST SOME OF BASIC ECONOMIC PROBLEMS,  
 ALTHOUGH THWARTED IN THIS EFFORT BY LABOR UNIONS AND  
 PCI AND PSI FROM GOING FAR ENOUGH TO ASSURE THEIR  
 RESOLUTION. END SUMMARY.

2. FISCAL PACKAGE. EMBASSY HAS REPORTED AT LENGTH  
 IN EARLIER MESSAGES ON INCREASES IN VARIOUS TAXES,  
 PUBLIC SERVICE TARIFFS AND ADMINISTERED PRICES. TABLE  
 1 BELOW SHOWS SUMMARY DATA ON THOSE PARTS OF FISCAL PACKAGE  
 DESIGNED TO REDUCE ORIGINAL FORECAST (JULY 1976)  
 OF TREASURY CASH DEFICIT OF ABOUT 13,600 BILLION  
 LIRE TO ABOUT 9,800 BILLION LIRE.

3. THERE ARE STILL GROUNDS FOR CONCERN THAT EXPENDITURES  
 WILL EXCEED CURRENT ESTIMATES AND RESULT IN  
 TREASURY DEFICIT SOMEWHAT LARGER THAN 9,800 BILLION  
 LIRE TARGET. HOWEVER, EVEN IF THIS SHOULD OCCUR,  
 INFLATIONARY EFFECT OF TREASURY DEFICIT IN 1977 SHOULD  
 STILL BE SIGNIFICANTLY LESS THAN IN PAST TWO YEARS.  
 RATIO OF TREASURY DEFICIT TO GDP WOULD FALL FROM  
 12.6 PERCENT IN 1975 TO ABOUT 10 PERCENT IN 1976 AND  
 6 PERCENT IN 1977 (WITH 9,800 BILLION LIRE TARGET).  
 EVEN IF THAT TARGET WERE NOT ACHIEVED, IT IS LIKELY  
 THAT RATIO OF DEFICIT TO GDP WOULD STILL FALL SUB-  
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STANTIALY FROM LEVEL IN PREVIOUS TWO YEARS. ALSO,  
 CENTRAL BANK FINANCING OF DEFICIT SHOULD BE CONSIDERABLY  
 LOWER THAN IN 1976, AS MORE OF DEFICIT IS FINANCED BY  
 BANKING SYSTEM AND BY PUBLIC.

#### 4. TABLE 1 - FISCAL PACKAGE (BILLIONS OF LIRE)

TAX MEASURES 1)	3,626
PUBLIC SERVICE TARIFFS 2)	301
ADMINISTERED PRICES 3)	92
TOTAL	4,019

#### OF WHICH PAID BY:

HOUSEHOLDS	3,286
BUSINESSES	733

1) MAINLY GASOLINE TAX, ADVANCE RECEIPTS ON INCOME  
 TAXES ON NON-WAGE INCOME AND STAMP AND REGISTRATION  
 TAXES.

2) INCLUDES REDUCED TRANSFER PAYMENTS BY TREASURY TO COVER POSTAL SYSTEM AND STATE RAILROADS DEFICITS, PLUS SOME VALUE ADDED TAX EARNED AS RESULT OF ELECTRIC AND TELEPHONE RATE INCREASES.

3) VALUE ADDED TAX REVENUE ARISING FROM ADMINISTERED PRICE INCREASES.

5. LABOR COST PACKAGE. FEBRUARY 4 DECREE LAW ON LABOR COSTS IS SUBJECT TO RATIFICATION BY PARLIAMENT WITHIN SIXTY DAYS. TWO PARTS OF "FISCALIZATION" LAW CONCERN: (1) STERILIZATION OF FEEDBACK THROUGH SCALA MOBILE OF TAX INCREASES NEEDED TO FINANCE FISCALIZATION OF SOCIAL CHARGES BORNE BY BUSINESS, AND (2) TAX DISINCENTIVE AND EXCLUSION FROM FISCALIZATION BENEFITS FOR BUSINESSES WHICH GRANT COMPANY LEVEL CONFIDENTIAL

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WAGE RATE INCREASES BEYOND THOSE AGREED TO IN NATIONAL CONTRACTS. BOTH MEASURES ARE NOW SUBJECT OF STRONG CRITICISM BY UNIONS AND BY PSI AND PCI. WHILE ELIMINATION OF THESE TWO FEATURES FROM FINAL VERSION OF LAW WOULD NOT SIGNIFICANTLY CHANGE EMBASSY ASSESSMENT OF VALUE OF LABOR COST PACKAGE, WE WOULD HOPE THAT GOI SUCCEEDS IN RETAINING THEM IN FINAL RATIFIED VERSION OF MEASURE.

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FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 2688

TREASURY DEPT WASHDC IMMEDIATE

INFO USMISSION EC BRUSSELS

AMCONSUL MILAN  
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6. TABLE 2 SUMMARIZES LATEST EMBASSY ESTIMATE OF QUANTITATIVE VALUE OF PACKAGE. FOOTNOTES BRIEFLY EXPLAIN NATURE OF EACH MEASURE. OUR CALCULATIONS SUGGEST THAT EFFECT OF LABOR COST PACKAGE ON ENTIRE ECONOMY (NOT JUST INDUSTRIAL SECTOR) WOULD BE TO REDUCE EXPECTED INCREASE IN DEPENDENT LABOR COSTS FROM ABOUT 25 PERCENT PRE-PROGRAM TO ABOUT 20 PERCENT POST-PROGRAM. CALCULATIONS IN TABLE 2 ASSUME APPROXIMATE 18.5 PERCENT AVERAGE INCREASE IN COST OF LIVING IN 1977 AND 24 POINT RISE IN SCALA MOBILE INDEX. THESE ARE SOMEWHAT LOWER FIGURES THAN THOSE USED IN SOME CONFIDENTIAL

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PREVIOUS CALCULATIONS ON GROUNDS THAT "UNDERLYING" INFLATIONARY FORCES MAY NOT BE AS STRONG AS PREVIOUSLY ASSUMED (SEE BELOW). NOTE ALSO THAT VALUE OF "PARTIAL BLOCK" (FORCED SAVINGS IN TREASURY SECURITIES) OF SCALA MOBILE INCREASES FOR WORKERS WITH INCOMES OF OVER 6 MILLION LIRE PER YEAR IS NOT INCLUDED IN TABLE 2. WHILE RELEVANT LAW SAYS THAT PROCEEDS FROM THESE TREASURY ISSUES SHALL BE USED FOR "INCENTIVES FOR PRODUCTIVE ACTIVITIES," IT IS NOT CLEAR WHEN, AND IN WHAT WAY, SUCH FUNDS MAY EVENTUALLY BE RETURNED TO BUSINESS SECTOR. AT MINIMUM, FORCED SAVINGS IN TREASURY SECURITIES WOULD ASSURE NEW SOURCE OF NON-INFLATIONARY FINANCING OF TREASURY DEFICIT IN AMOUNT OF ABOUT 900 BILLION LIRE.

7. TABLE 2 - LABOR COST PACKAGE FOR 1977 (BILLIONS OF LIRE)

SCALA MOBILE:

ELIMINATION OF "ANAMOLIES" 1)	325
UNLINKING OF SEVERAGE PAY 2)	489
SUB-TOTAL	814

LIMITS ON COMPANY LEVEL WAGE NEG. 3) 1,190  
FISCALIZATION OF SOCIAL COSTS 4) 1,142  
TOTAL 3,456

MEMO: INCREASE IN 1977 DEPENDENT LABOR COSTS:

PRE-PROGRAM 24.9 PERCENT  
POST-PROGRAM 20.5 PERCENT

- 1) ELIMINATE ALL CONTRACTUAL ARRANGEMENTS WHEREBY LIRE VALUE OF 1 SCALA MOBILE POINT EXCEEDS THAT WHICH GENERALLY PREVAILS IN INDUSTRY, COMMERCE AND AGRICULTURE.
- 2) UNLINK SCALA MOBILE ADJUSTMENTS AS COMPONENT OF BASE PAY IN CALCULATION OF SEVERANCE PAY.
- 3) ASSUMED TO BE 1.5 PERCENT OF DEPENDENT LABOR COSTS LESS  
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THAN WOULD OTHERWISE HAVE OCCURRED.

- 4) EMBASSY ESTIMATE OF VALUE OF FISCALIZATION MEASURE.

8. TRANSFER OF RESOURCES. TABLE 3 SHOWS SUMMARY OF NET TRANSFERS OF RESOURCES AMONG THREE ECONOMIC SECTORS AS RESULT OF ENTIRE STABILIZATION PROGRAM, I.E., AMONG HOUSEHOLDS, BUSINESSES AND PUBLIC ADMINISTRATION. COMBINED EFFECT ON HOUSEHOLDS OF FISCAL PACKAGE AND LABOR COST PACKAGE WOULD BE TO REDUCE DISPOSABLE INCOME BY ABOUT 6,700 BILLION (CURRENT) LIRE. BUSINESSES WOULD HAVE NET GAIN OF ABOUT 2,700 BILLION LIRE AND PUBLIC ADMINISTRATION WOULD HAVE NET CASH RECEIPTS OF 4,000 BILLION LIRE. PROGRAMMED INTENT OF THESE MEASURES IS: (1) TO REDUCE DISPOSABLE INCOME AVAILABLE TO HOUSEHOLDS FOR PRIVATE CONSUMPTION AND FOR IMPORTS, (2) TO IMPROVE FINANCIAL SITUATION OF BUSINESS SECTOR SO AS TO PERMIT RAPID GROWTH OF EXPORTS AND BEGINNING OF RECOVERY OF FIXED INVESTMENT, AND (3) TO REDUCE INFLATIONARY IMPACT OF TREASURY DEFICIT AND ITS PRE-EMPTING OF CREDIT AT EXPENSE OF PRIVATE BUSINESS. EMBASSY MAKES FOLLOWING ASSUMPTIONS IN ESTIMATING EFFECT OF TRANSFER OF RESOURCES ON GDP IN 1977: (1) HOUSEHOLDS WILL INITIALLY ATTEMPT TO MAINTAIN PATTERN OF PRIVATE CONSUMPTION DESPITE EFFECT OF PROGRAM ON DISPOSABLE INCOME BY TEMPORARILY RAISING THEIR PROPENSITY TO CONSUME, (2) BUSINESSES WILL USE PART OF RESOURCES RECEIVED TO IMPROVE FINANCIAL POSITION SO THAT INCREASE IN FIXED INVESTMENT WILL BE RELATIVELY SMALL, AT LEAST DURING 1977, AND (3) EVEN IF TREASURY EXPENDITURE LEVELS EXCEED CURRENT ESTIMATES BY AS MUCH AS 2,500 BILLION LIRE, THIS WILL PARTLY BE OFFSET BY ABOUT 1,000 BILLION LIRE IN UNDER-ESTIMATED REVENUES. THUS, TOTAL CREDIT TO TREASURY TO COVER DEFICIT WOULD STILL REMAIN WITHIN 11,000 TO 11,500

BILLION LIRE RANGE.

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9. TABLE 3 - TRANSFER OF RESOURCES (BILLIONS OF LIRE)

	HOUSEHOLDS	BUSINESS	PUBLIC - ADMIN
TAX, TARIFF, AND			
PRICE MEASURES	-3,286	-733	4,019
LABOR COST MEASURES	-3,456	3,456	-
TOTAL	-6,742	2,723	4,019

10. GDP IN 1977. EMBASSY HAS PREPARED NEW ROUGH ESTIMATE OF GDP IN REAL TERMS IN 1977 BASED UPON HISTORIC RATIOS BUT MODIFIED BY JUDGMENTAL DECISION MAINLY CONCERNING EFFECT OF PRESENT STAGE OF BUSINESS CYCLE ON THESE VARIABLES. TABLE 4 BELOW SHOWS THAT RESULT OF STABILIZATION PROGRAM WOULD BE SLOW-DOWN IN ECONOMIC GROWTH SO THAT REAL GDP IN 1977 MIGHT IN FACT FALL BY ABOUT 1.2 PERCENT COMPARED TO 1976 LEVEL. BECAUSE OF SOME INCREASE IN PROPENSITY TO CONSUME, PRIVATE CONSUMPTION WOULD DECLINE BY ONLY 0.6 PERCENT. PUBLIC CONSUMPTION WOULD CONTINUE TO RISE AND WOULD REFLECT DELAYED EFFECTS OF LATE 1975 ANTI-RECESSION PACKAGE AND TO SOME EXTENT NEW PUBLIC EXPENDITURES. FIXED INVESTMENT WOULD RISE BY ABOUT 3 PERCENT FROM EXCEPTIONALLY LOW LEVEL REACHED IN 1975 AND 1976. WHILE THIS FIGURE ASSUMES SOME LIMITED IMPROVEMENT DUE TO TRANSFER OF RESOURCES TO BUSINESS SECTOR UNDER STABILIZATION PROGRAM, MAIN RATIONALE IS THAT ABSOLUTE LEVEL OF FIXED INVESTMENT HAS BEEN AT VERY LOW LEVEL SO THAT PLANT AND EQUIPMENT REPLACEMENT CYCLE MUST BEGIN SOON IN ORDER TO PERMIT OVERALL LEVEL OF ECONOMIC ACTIVITY REACHED IN 1976 TO CONTINUE AT ONLY SLIGHTLY REDUCED RATE IN 1977. EXPORTS OF GOODS AND SERVICES ARE BASED UPON ASSUMED GROWTH OF ITALY'S MARKETS OF ABOUT 6.5 PERCENT PLUS ABOUT 1 PERCENT INCREASE IN ITALY'S SHARE OF MARKET, BOTH BECAUSE OF LAGGED EFFECT OF DEPRECIATION OF LIRA AND BECAUSE OF RELATIVELY LOWER LEVEL OF DOMESTIC DEMAND IN ITALY THAN IN ITALY'S MAIN COMPETITORS. REAL IMPORTS OF GOODS AND SERVICES WOULD FALL BY ABOUT 3 PERCENT AFTER VERY SHARP INCREASE IN 1976 (WHICH PROBABLY RESULTED IN SOME BUILD-UP OF INVENTORIES

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LATE IN 1976 IN ANTICIPATION OF COMMODITY PRICE RISES AND FURTHER DEPRECIATION OF LIRA).

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FM AMEMBASSY ROME  
TO SECSTATE WASHDC IMMEDIATE 2689  
TREASURY DEPT WASHDC IMMEDIATE  
INFO USMISSION EC BRUSSELS  
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AMCONSUL FLORENCE  
AMCONSUL GENOA  
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11. WHILE MODEST DECLINE IN GDP FORECAST FOR 1977  
IS NOT POLITICALLY ATTRACTIVE, IT WOULD NOT REPRESENT  
UNACCEPTABLE ECONOMIC SACRIFICE, GIVEN HIGH ABSOLUTE  
LEVEL OF ACTIVITY WHICH WOULD STILL PREVAIL. (GENERAL  
PUBLIC STILL DOES NOT SEEM TO BE AWARE OF RAPID  
RECOVERY OF ITALIAN ECONOMY IN 1976. EMBASSY ESTIMATES  
REAL GDP GROWTH LAST YEAR AT 6 PERCENT, RESULTING IN  
HIGHEST LEVEL OF ECONOMIC ACTIVITY EVER RECORDED IN  
ITALIAN HISTORY.)

12. TABLE 4 - GDP (PERCENT CHANGE 1970 LIRE)

1974	1975	1976	1977
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PRIVATE CONSUMPTION	2.5	-1.8	2.2	-0.6
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PUBLIC CONSUMPTION	2.1	0.8	2.6	3.5
FIXED INVESTMENT	3.7	-12.7	0.2	2.9
EXPORTS G AND S	10.0	3.1	13.3	7.5
IMPORTS G AND S	2.0	-10.0	15.4	-3.0
GDP	3.4	-3.7	6.0	-1.2

MEMO: NET G AND S IN 1970 LIRE: 220 1980 1987 3595

13. BALANCE OF PAYMENTS. TABLE 5 BELOW SHOWS REOUGH ESTIMATE OF ITALY'S BALANCE OF PAYMENTS FOR 1977. BECAUSE OF WIDE SWINGS IN INVENTORY ACCUMULATION AND COMMODITY PRICES IN RECENT YEARS, IT HAS BECOME PARTICULARLY DIFFICULT TO FORECAST MERCHANDISE TRADE. IN ANY CASE, EMBASSY BELIEVES THAT CURRENT-ACCOUNT IN 1977 WILL BE IN APPROXIMATE BALANCE, OR VERY SMALL DEFICIT. OVERALL FINANCING PROBLEM MAY, HOWEVER, BE SOMEWHAT LARGER ON ASSUMPTION THAT LARGE INFLOW OF SHORT-TERM BANK AND SUPPLIER CREDITS IN 1976 WILL AT LEAST PARTIALLY TURN AROUND IN 1977.

14. GOI AND BOI ARE CLEARLY PREOCCUPIED ABOUT POSSIBLE SHORT-TERM CAPITAL OUTFLOWS IN NEXT FEW MONTHS AND ABOUT EFFECT ON LIRA OF ANY UNEXPECTED POLITICAL OR ECONOMIC DEVELOPMENTS WHICH MIGHT CAUSE CRISIS OF CONFIDENCE. EMBASSY ESTIMATES THAT ANY BACKLOG OF SHORT-TERM CAPITAL AS OVERHANG FROM FOREIGN EXCHANGE CONTROLS WHICH MIGHT FLOW OUT OF ITALY IN NEXT FEW MONTHS IS ON THE ORDER OF \$1.0 TO \$1.5 BILLION. GIVEN CONVERTIBLE CURRENCY RESERVES OF ABOUT \$3 BILLION AT PRESENT, SUCH AN OUTFLOW COULD BE ABSORBED. HOWEVER, THIS WOULD NOT LEAVE MUCH MARGIN FOR ERROR. THUS, ITALIAN AUTHORITIES WOULD CERTAINLY FEEL MORE COMFORTABLE IF THEY HAD AVAILABLE ADDITIONAL SHORT-TERM FINANCING TO MEET WITH UNEXPECTED RUN ON THE LIRA. FINALLY, AMORTIZATION OF CERTAIN MONETARY LIABILITIES  
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INCLUDED IN TABLE 5 ARE SCHEDULED FOR 1977, I.E., ABOUT \$825 MILLION IN REPAYMENTS ON 1974 IMF STANDBY, AND \$500 MILLION REPAYABLE ON BUDDSEBANK GOLD LOAN.

15. THUS, AS REGARDS ONE OF ITALY'S TWO IMMEDIATE PROBLEMS, I.E., BALANCE OF PAYMENTS, 1977 WOULD BE A YEAR IN WHICH CONSIDERABLE REAL ADJUSTMENT WOULD HAVE BEEN ACHIEVED. ADJUSTMENT PROCESS HAS IN FACT BEEN WORKING CONTINUOUSLY SINCE 1974, AS CAN BE SEEN IN MEMO ITEM TO TABLE 4 WHICH SHOWS STEADY GROWTH OF NET FOREIGN SURPLUS ON GOODS AND SERVICES IN 1970 LIRE.

16. TABLE 5 - BALANCE OF PAYMENTS (MILLIONS OF DOLLARS)



	1974	1975	1976	1977
EXPORTS	30,074	34,492	36,767	41,510
IMPORTS	38,568	35,547	40,536	42,605
TRADE BAL.	-8,494	-1,155	-3,769	-1,095
SERVICES; UN. TR.	475	602	918	875
CURR. ACCT.	-8,019	-553	-2,851	-220
CAP. ACCT./ADJUST.	2,474	-1,451	1,564	-1,300
TOTAL DEFICIT	-5,545	-2,004	-1,287	-1,520

17. INFLATION. EFFECT OF STABILIZATION PROGRAM IN REDUCING SECOND OF ITALY'S TWO CRITICAL PROBLEMS, I.E., INFLATION, IS DIFFICULT TO QUANTIFY IN 1977. MOST PRE-PROGRAM STATISTICAL FORECASTS SEEM TO BE BASED UPON ASSUMPTION THAT COST OF LIVING WILL RISE BY 20-25 PERCENT ON AVERAGE IN 1977. FORECASTERS THEN CALCULATE FEEDBACK EFFECT ON LABOR COSTS THROUGH SCALA MOBILE WAGE INDEXATION SYSTEM. IT IS DIFFICULT TO AVOID CIRCUITOUS REASONING USING SUCH AN APPROACH. EMBASSY HAS COME TO QUESTION WHERE BASIC SOURCES OF INFLATION WILL COME FROM IN 1977. DURING PERIOD 1974-1976, WHEN ITALY HAD VERY RAPID RATE OF INFLATION, THERE WERE TWO LARGE-IMPACT DEVELOPMENTS WHICH SOULD NOT

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BE REPEATED IN 1977: MASSIVE OIL PRICE INCREASE IN LATE 1973, AND SUDDEN DEPRECIATION OF LIRA IN EARLY MONTHS OF 1976. FOR 1977, EMBASSY PROJECTIONS ALREADY ASSUME PETROLEUM PRICE INCREASE OF AT LEAST 10 PERCENT. BECAUSE OF POSITION TAKEN BY SAUDI ARABIA, THIS COULD PROVE TO BE LOWER. AVERAGE DEPRECIATION OF LIRA MAY BE ON ORDER OF 10 PERCENT OVER 1976 LEVEL, BUT 5 PERCENT OF THIS INCREASE HAD ALREADY OCCURRED BY MID-JANUARY.

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18. IN ANALYZING SOURCES OF INFLATION, NEITHER ON DEMAND-PULL SIDE NOR ON COST-PUSH SIDE DOES IT SEEM LIKELY THAT AVERAGE INFLATION RATE WILL BE AS HIGH AS 20-25 PERCENT RANGE. 1977 WOULD BE YEAR OF SLIGHT DECLINE IN GDP. WHILE PRODUCTIVE CAPACITY HAS BEEN INCREASINGLY UTILIZED DURING 1976 RECOVERY AND SOME SCATTERED BOOTLENCKS MAY BE DEVELOPING, IT DOES NOT APPEAR THAT TOTAL DEMAND WILL PLACE SERIOUS INFLATIONARY STRESS ON ECONOMY'S TOTAL PRODUCTIVE CAPACITY. SIMILARLY, ON COST SIDE, EMBASSY ESTIMATES THAT: (1) DOLLAR IMPORT PRICES WILL RISE BY SLIGHTLY MORE THAN 8 PERCENT, (2) EXCHANGE RATE ON AVERAGE WILL DEPRECIATE ABOUT 10 PERCENT, (3) DEPENDENT  
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LABOR COSTS (EXCLUDING SCALA MOBILE FEEDBACK) WILL RISE BY ABOUT 14 PERCENT. IN ADDITION, BUSINESS' TAX BURDEN WOULD RISE, MAINLY BECAUSE OF EW 75 PERCENT ADVANCE PAYMENT OF TAXES ON NON-WAGE AND SALARY INCOME. ON OTHER HAND, INTEREST COSTS TO BUSINESS SHOULD, IF ANYTHING, DECLINE. ON BASIS OF SOME DATA ON BUSINESS FINANCE CONCERNING RELATIVE WEIGHTS OF VARIOUS BUSINESS COSTS, EMBASSY CALCULATES THAT AVERAGE COST OF LIVING MIGHT RISE BY 17-17.5 PERCENT IN 1977. AN ALTERNATE ESTIMATE BASED ON A ROUGH TREND PROJECTION OF RATE OF RISE IN COST OF LIVING (EXCLUDING RATCHET EFFECTS OF OIL PRICE INCREASE AND LIRA DEPRECIATION) SUGGESTS AVERAGE INCREASE OF PERHAPS 18.5 PERCENT. ADMITTEDLY, NONE OF THESE ESTIMATES ARE VERY RELIABLE. HOWEVER, THEY DO CALL INTO QUESTION SOME BASIC ASSUMPTIONS ABOUT INFLATION WHICH SEEM TO BE

BEHIND ESTIMATES MADE BOTH INSIDE ITALY AND BY INTERNATIONAL ORGANIZATIONS. ALSO, AVERAGE RATE OF INCREASE IN COST OF LIVING WILL NOT BE BEST MEASUREMENT OF PROGRESS IN REDUCING RATE OF INFLATION. BECAUSE OF PATTERN OF INCREASE OF COST OF LIVING IN 1976, ITALY WOULD HAVE INCREASE IN AVERAGE COST OF LIVING IN 1977 OF 9.5 PERCENT, EVEN IF THERE WERE NO RISE IN COST OF LIVING INDEX FROM DECEMBER 1976 TO DECEMBER 1977. THUS, IF AVERAGE RISE IN COST OF LIVING WERE ON THE ORDER OF 17.5 TO 18.5 BUT DECELERATING, THEN DECEMBER TO DECEMBER INCREASE WOULD BE IN RANGE ABOUT 12.0 TO 13.5. THIS WOULD BE BETTER MEASURE OF SUCCESS OF PROGRAM. THIS COMPARES, FOR EXAMPLE, WITH DECEMBER TO DECEMBER INCREASE OF 11 PERCENT IN 1975, DURING SIMILAR DOWNTURN IN ECONOMIC ACTIVITY.

19. TABLE 6 - COST OF LIVING (PERCENT CHANGE

	1974	1975	1976	1977
YEAR TO YEAR AVERAGE	19.4	17.2	16.5	18.5
DECEMBER TO DECEMBER	25.3	11.1	21.8	13.5

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20. CONTINUED STABILIZATION EFFORTS. BOTH FOR ECONOMIC AND POLITICAL REASONS, USG AND INTERNATIONAL LENDING AGENCIES SHOULD KEEP PRESSURE ON GOI NOT TO STOP AT MEASURES NOW TAKEN BUT TO MOVE ON TO ADDRESS GOVERNMENT EXPENDITURE AND LABOR COST QUESTIONS. PROSPECTS FOR SERIOUSLY TACKLING REMAINING FISCAL AND LABOR COST PROBLEMS ARE HIGHLY UNCERTAIN, BUT BETTER IN FIRST AREA THAN SECOND. FOR SOME MONTHS, GOI AND PUBLIC HAVE COME TO RECOGNIZE THAT PERSISTENT DEFICITS NOT ONLY OF CENTRAL GOVERNMENT BUT OF AUTONOMOUS ENTITIES (ESPECIALLY POSTAL SYSTEM AND RAILROADS), MUNICIPAL GOVERNMENTS, AND SOCIAL INSURANCE INSTITUTES CANNOT CONTINUE. SOME MEASURES ARE ALREADY UNDER CONSIDERATION: (1) MORE FREQUENT INCREASES IN POSTAL FEES AND RAILROAD TARIFFS (THERE HAVE BEEN TWO RAILROAD RATE INCREASES IN LAST FEW MONTHS), (2) RESTORATION OF INCREASED TAXING AUTHORITY TO MUNICIPAL GOVERNMENTS, (3) POSSIBLE FREEZE ON HIRING BY MUNICIPAL GOVERNMENTS, (4) REQUIREMENT THAT LOCAL GOVERNMENTS FINANCE DEFICITS SOLELY THROUGH SAVINGS AND DEPOSIT FUND SO AS TO PERMIT BETTER FINANCIAL CONTROL BY CENTRAL GOVERNMENT, AND (5) ADOPTION OF MINIMUM CHARGES ON MEDICINES OBTAINED THROUGH HEALTH INSURANCE SYSTEM.

21. ON LABOR COST SIDE, VIRTUALLY NOTHING HAS BEEN DONE TO REDUCE EFFECT OF SCALA MOBILE IN PERPETUATING

INFLATION ONCE INFLATIONARY PRESSURES ARE GENERATED  
BY INTERNAL OR FOREIGN DEVELOPMENTS. HOWEVER,  
1975 CONTRACTUAL ARRANGEMENT BETWEEN UNIONS AND  
CONFINDUSTRIA IS SCHEDULED FOR RENEWAL IN BEGINNING  
OF 1978. JUST POSSIBLY BY THAT TIME UNIONS MAY HAVE  
COME AROUND TO BELIEF THAT UNREALISTIC WAGE RATE WITH  
ITS NEGATIVE CONSEQUENCES FOR EMPLOYMENT AND INFLATION  
IS NOT IN THEIR BEST INTEREST, AND SOME MORE SUBSTANTIAL  
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MODIFICATION CAN BE MADE IN SCALA MOBILE MECHANISM.  
ALSO, POSSIBILITY OF COMPLETELY ABOLISHING SEVERANCE  
PAY IS ALREADY BEING CONSIDERED AND ATTENTION MUST BE  
GIVEN TO LINKING PERMANENTLY FUTURE WAGE CONTRACT  
NEGOTIATIONS TO PRODUCTIVITY GROWTH.BEAUDRY

CONFIDENTIAL

NNN

## Message Attributes

**Automatic Decaptioning:** Z  
**Capture Date:** 01-Jan-1994 12:00:00 am  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** ECONOMIC STABILITY, INTELLIGENCE ASSESSMENTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Sent Date:** 10-Feb-1977 12:00:00 am  
**Decaption Date:** 22 May 2009  
**Decaption Note:** 25 YEAR REVIEW  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 22 May 2009  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1977ROME02175  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** GS  
**Errors:** N/A  
**Expiration:**  
**Film Number:** D770047-1114  
**Format:** TEL  
**From:** ROME  
**Handling Restrictions:**  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1977/newtext/t19770254/aaaabvnpn.tel  
**Line Count:** 621  
**Litigation Code IDs:**  
**Litigation Codes:**  
**Litigation History:**  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Message ID:** ed4d74c8-c288-dd11-92da-001cc4696bcc  
**Office:** ACTION EUR  
**Original Classification:** CONFIDENTIAL  
**Original Handling Restrictions:** LIMDIS  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 12  
**Previous Channel Indicators:** n/a  
**Previous Classification:** CONFIDENTIAL  
**Previous Handling Restrictions:** LIMDIS  
**Reference:** 77 ROME 1940  
**Retention:** 0  
**Review Action:** RELEASED, APPROVED  
**Review Content Flags:**  
**Review Date:** 23-Nov-2004 12:00:00 am  
**Review Event:**  
**Review Exemptions:** n/a  
**Review Media Identifier:**  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**SAS ID:** 3353804  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** ITALIAN STABILIZATION PROGRAM: AN ASSESSMENT  
**TAGS:** EFIN, ECON, IT  
**To:** STATE TRSY  
**Type:** TE  
**vdkgvwkey:** odb://SAS/SAS.dbo.SAS\_Docs/ed4d74c8-c288-dd11-92da-001cc4696bcc  
**Review Markings:**  
Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
22 May 2009  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009